

Attorney for Applicants

IN THE MATTER OF THE CONVERSION)
OF BLUE CROSS AND BLUE SHIELD OF)
MONTANA, INC. AND ALLIANCE WITH)
HEALTH CARE SERVICE)
CORPORATION,)
)
Applicants.)
)
)

Case No.: INS-2012-238

FEBRUARY 8, 2013

1 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

2 **A.**My name is Calvin Swartley. I am a Senior Manager of Moss Adams LLP and a member
3 of its Valuation & Litigation Services Group. My business address is 805 SW Broadway,
4 Suite 1200, Portland, Oregon, 97205.

5 **Q. HOW LONG HAVE YOU BEEN WITH MOSS ADAMS LLP?**

6 **A.**Since 1998.

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND,**
8 **QUALIFICATIONS AND EXPERIENCE.**

9 **A.**I graduated in 1993 from Lewis & Clark College in Portland, Oregon with a Bachelor of
10 Science in Business Administration. I received a Master of Business Administration
11 degree from Washington University in St. Louis, Missouri in 1998. In 2001, I received a
12 Chartered Financial Analyst (CFA) designation from the CFA Institute. In 2003, I
13 became an Accredited Senior Appraiser (ASA) from the American Society of Appraisers.
14 I am in good standing as a member of the CFA Institute, the American Society of
15 Appraisers, the Portland Chapter of the ASA and the CFA Society of Portland.

16 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN FORMAL PROCEEDINGS BEFORE**
17 **AN OFFICER OF THIS STATE OR IN FORMAL PROCEEDINGS IN ANY**
18 **OTHER STATE OR THE FEDERAL GOVERNMENT?**

19 **A.**No, I have not.

20 **Q. ARE YOU FAMILIAR WITH THE TRANSACTION THAT IS THE SUBJECT**
21 **OF THE PROCEEDING?**

1 **A.** Yes, I am.

2 **Q.** **WHAT IS YOUR INVOLVEMENT IN THE TRANSACTION THAT IS THE**
3 **SUBJECT OF THE PROCEEDING?**

4 **A.** I was retained by Blue Cross Blue Shield of Montana (“BCBSMT” or “Company”) in
5 August, 2012 to determine the fair market value of its total surplus. As part of that
6 analysis, I determined the fair market value of the total equity of the Company’s
7 subsidiary, Health-E-Web, and the fair market value of certain of the Company’s assets
8 and liabilities for financial planning purposes as of June 30, 2012. I was also retained to
9 assist BCBSMT in related responses to any regulatory or other proceedings or inquiries
10 regarding our valuation.

11 **Q.** **HAD YOU OR YOUR FIRM BEEN RETAINED BY BCBSMT OR HEALTH**
12 **CARE SERVICE CORPORATION TO PERFORM ANY OTHER SERVICES**
13 **PRIOR TO YOUR ENGAGEMENT FOR THAT VALUATION?**

14 **A.** No.

15 **Q.** **DID YOU PERFORM THE VALUATION ANALYSES THAT YOU WERE**
16 **RETAINED BY BCBSMT TO PERFORM?**

17 **A.** Yes, I did. I prepared a Report which was provided to BCBSMT on November 12, 2012,
18 regarding Valuation Analysis Blue Cross Blue Shield of Montana as of June 30, 2012,
19 which is attached to my testimony as Exhibit 1 (the “Valuation Analysis.”).

20 **Q.** **WERE YOU INVOLVED IN THE NEGOTIATIONS OF THE PROPOSED**
21 **TRANSACTION BETWEEN HCSC AND BCBSMT?**

22 **A.** No, I was not.

1 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR TESTIMONY.**

2 **A.**I will testify on behalf of the applicants in this proceeding, BCBSMT and Health Care
3 Service Corporation, a Mutual Legal Reserve Company ("HCSC"), regarding our
4 calculation of the fair market value of the total surplus of BCBSMT. I will also testify as
5 to facts relating to Moss Adams' engagement by BCBSMT.

6 **Q. DID YOU PERFORM A FAIR MARKET VALUATION OF THE TOTAL**
7 **SURPLUS OF BCBSMT?**

8 **A.**Yes, I did.

9 **Q. WHAT VALUE DID YOU PLACE ON THE TOTAL SURPLUS OF BCBSMT?**

10 **A.**I valued the surplus at \$166.2 million.

11 **Q. HOW DID YOU ARRIVE AT THAT VALUE?**

12 **A.**I began the valuation by considering the factors identified in Internal Revenue Service
13 Ruling 59-60 for determining fair market value, which is the price at which property
14 would change hands between a willing buyer and seller.

15 I then considered three valuation approaches: (1) the Income Approach, in which
16 estimated future returns are discounted to present value at an appropriate rate of return on
17 investment; (2) the Market Approach, in which valuation ratios derived from market
18 transactions involving companies that are similar to the subject business (past
19 transactions involving the subject business, if any, are also considered); and (3) the
20 Asset-Based Approach, in which the assets and liabilities of the business are restated
21 from historical cost to fair market value.

1 Within the Market Approach, I considered both a public company analysis and a merger
2 and acquisition analysis. The public company analysis uses stock market transactions
3 involving publicly traded companies that are similar in nature to the subject business,
4 while the merger and acquisition analysis uses merger and acquisition transactions
5 involving companies that are similar in nature to the subject business.

6 Within the Asset-Based Approach, I considered both the direct Asset-Based Approach
7 and the Residual Income Approach. In the direct Asset-Based Approach, the Company's
8 net asset value is estimated by restating the value of assets and liabilities from historical
9 cost to estimated fair market value. The Residual Income Approach utilizes the results of
10 the Asset-Based Approach and includes the present value of the Company's expected
11 future residual income.

12 I valued BCBSMT surplus under each approach and arrived at the following indicated
13 surplus values by approach:

14	Income Approach	\$125,406,000
15	Market Approach (Public Company Analysis)	\$175,651,000
16	Market Approach (Merger and Acquisition Analysis)	\$147,247,000
17	Residual Income Approach	\$164,168,000
18	Direct Asset-Based Approach	\$146,557,000

19 **Q. HOW DID YOU REACH A FINAL VALUE NUMBER UTILIZING THAT**
20 **RANGE OF VALUES?**

21 **A.** The final step in our valuation process was to review each of the approaches above and
22 reconcile them to arrive at a final estimated surplus value. The weight given to each

1 approach depends on the quantity and quality of available data, the valuation function and
2 purpose, the value premise and definition and the reliability of the analysis.

3 I assigned some weight (5%) to the Income Approach because it represents the amount a
4 prudent investor would pay for expected future cash flows based on market rates of
5 returns and the Company's specific risks. The Market Approach (Public Company
6 Analysis) was given significant weight (35%) because it reflects current stock market
7 pricing for reasonably comparable businesses that represent alternative investment
8 opportunities. I also gave significant weight (60%) to the Residual Income Approach
9 within the Asset-Based Approach because it captures the value of the company's total
10 surplus as well as future earnings ability in excess of a potential investor's return on
11 equity.

12 I assigned no weight (0%) to the Market Approach (Merger and Acquisition Analysis)
13 because of limits in finding recent transactions for closely similar companies and
14 difficulties using merger and acquisition data. I also assigned no weight to the direct
15 Asset-Based Approach because of significant overlap between that approach and the
16 Residual Income Approach. I believe the Residual Income Approach better captures the
17 Company's future excess earnings ability in addition to the book value of surplus.

18 Applying these weighting factors against the indicated surplus values determined under
19 the Income Approach, Residual Income Approach and Market Approach (Public
20 Company Analysis), I arrived at the estimate of \$166,200,000 as the fair market value of
21 the company's total surplus on a majority interest, going forward basis.

22 **Q. WHAT DATA AND OTHER INFORMATION DID YOU RELY ON IN**
23 **ARRIVING AT YOUR VALUATION?**

1 **A.** I relied primarily on BCBSMT's detailed historical financial statements and financial
2 projections provided by BCBSMT. I also discussed with BCBSMT senior management
3 the current and future operations of BCBSMT, and reviewed information concerning the
4 industry and economy in which BCBSMT operates, including a search for comparable
5 public companies and merger and acquisition data of comparable companies. I also
6 conducted a site visit to BCBSMT in September, 2012.

7 I also relied on the November 9, 2012, report prepared by Actuarial Services & Financial
8 Modeling, Inc. ("ActMod"), an actuarial and financial modeling company with
9 specialized expertise in actuarial services related to the health care industry, which was
10 incorporated into the Residual Income Approach of my report. I relied on ActMod's
11 actuarial appraisal of the \$17.6 million present value of BCBSMT's expected future
12 residual income as of June 30, 2012.

13 **Q. DID YOU REVIEW THE ACTMOD VALUATION BEFORE YOU RELIED ON**
14 **IT?**

15 **A.** Yes, I did. I reviewed the underlying assumptions and methodology.

16 **Q. WHY DID YOU RELY ON ANOTHER VALUATION EXPERT'S WORK IN**
17 **YOUR REPORT?**

18 **A.** It is my understanding that ActMod is a very specialized actuarial valuation organization,
19 with significant experience in the health insurance industry. BCBSMT advised me when
20 I was retained that ActMod was retained to do an actuarial valuation focused on the core
21 insurance business of BCBSMT rather than undertake a more comprehensive financial

1 valuation of BCBSMT's entire business. I was comfortable with that because of
2 ActMod's actuarial expertise in the health insurance business.

3 **Q. DID YOU PERFORM A VALUATION OF THE ASSETS AND LIABILITIES OF**
4 **BCBSMT?**

5 **A.** With the exception of the valuation I did of BCBSMT and the subsidiary, Health-E Web,
6 and various real estate owned by BCBSMT, I did not perform individual market value
7 estimates of each asset and liability recorded by BCBSMT. I utilized information from
8 BCBSMT management to adjust any recorded assets and liabilities to fair market values,
9 as needed, for purposes of incorporating those restated values into the direct Asset-Based
10 Approach analysis (Exhibit 22) and Residual Income approach (Exhibit 21).

11 **Q. WHAT INFORMATION DID YOU RELY ON IN ARRIVING AT THE**
12 **RESTATED ASSET AND LIABILITY VALUES?**

13 **A.** My analysis included a review of various financial statements and analysis, including
14 historical income statements and balance sheets, management projections of financial
15 statements, an internal analysis of various real estate holdings, actuarial studies, life
16 insurance statements, bank and other financial institution statements, the sale proceeds of
17 various assets, etc. A listing of the information used in our analysis can be found in
18 Schedule 3: Sources of Information in our report. Any adjustments to historical cost were
19 made based on discussions with management. The restated asset and liability values I
20 arrived at under this methodology are reported in Exhibit 22 of our report, which is a
21 summary of my conclusions under the direct Asset-Based Approach, and also in Exhibit
22 24, which is a more detailed management report I prepared showing potential

1 transactional allocation of asset, liability and estimated residual income values underlying
2 our estimate of surplus value under the Residual Income Approach (see Exhibit 21).

3 **Q. WHAT WAS THE PURPOSE OF EXHIBIT 24?**

4 **A.** Exhibit 24 is a more detailed, line-item restatement of the balance sheet using the
5 estimates I arrived at under the Residual Income Approach (see Exhibit 22). BCBSMT
6 management requested this balance sheet to assist it in analyzing business transactions
7 potentially involving the transfer of assets and/or liabilities to another entity or purchaser.
8 It has no direct relevance to the valuation, but reflects the facts used in the valuation.

9 **Q HOW DID YOU ARRIVE AT THE VALUES AND ALLOCATIONS IN EXHIBIT**
10 **24?**

11 **A.** I identified by line item the restated historical cost of BCBSMT's assets and liabilities
12 performed under the direct Asset Based Approach (Exhibit 22) and, as required under the
13 Residual Income Approach, added the \$17.6M present value of residual income reflected
14 in Exhibit 21 of our report to arrive at an "Adjusted Assets Less Liabilities" (or surplus
15 value) of \$164,168,000. I then assigned assets and liabilities to one of two columns,
16 "Destination NewCo" or "Destination OldCo", based on discussions and analysis
17 provided by management of BCBSMT. With the exceptions of the addition to the balance
18 sheet of the estimated \$17.6M present value of the Residual Income, the values were the
19 same as the values assigned in Exhibit 22 to each asset and liability.

20 **Q. WHAT INFORMATION DID YOU RELY ON IN ARRIVING AT THESE**
21 **VALUES?**

1 Adjustments to historical cost were made based on a review of various financial
2 statements and analysis, including historical income statements and balance sheets,
3 management prepared information, an internal analysis of various real estate holdings,
4 actuarial studies, life insurance statements, bank and other financial institution
5 statements, the sale proceeds of various assets, etc. and other indications of value
6 specific to certain assets and liabilities, as reported (Exhibit I, Exhibits 21, 22, and 24).
7 Allocations of assets and liabilities between "Destination NewCo" and "Destination
8 OldCo" were made based on discussions and analysis provided by management of

9 **Q. DID YOU CONSIDER CAPITAL EXPENDITURES IN YOUR VALUATION?**

10 **A.** Yes, I did.

11 **Q. WHAT AMOUNT OF CAPITAL INVESTMENT DID YOU INCLUDE IN YOUR**
12 **VALUATION AND WHY?**

13 **A.** Based on information provided by BCBSMT management, I learned that BCBSMT's
14 recent financial and operating challenges had prevented it from implementing even
15 baseline capital improvements needed with respect to its administrative and claims
16 processing systems. I also learned that ACA demands would require additional capital
17 expenditures above and beyond recurring investments. Based on that information, I
18 included in my valuation at Exhibit 12 recurring capital expenditures, exclusive of non-
19 recurring upgrades, of approximately \$48.8M. Based on management estimates of
20 approximately \$60M of proposed investments, we projected \$20.8M additional capital
21 expenditures on a present value basis for the period 2013-2032, as shown in my report at
22 Exhibit 13.

1 **Q. WHEN WAS YOUR FINAL REPORT DELIVERED TO BCBSMT?**

2 **A. November 12, 2012.**

3 **Q: DID HCSC HAVE ANY INPUT INTO YOUR VALUATION OPINION BEFORE**
4 **YOU DELIVERED THE REPORT TO BCBSMT?**

5 **A. No.**

6 **Q: DID EITHER BCBSMT OR HCSC INFLUENCE YOU OR ATTEMPT TO**
7 **INFLUENCE YOUR OPINION IN ANY WAY?**

8 **A. I had no conversations or communications with HCSC during the preparation of my**
9 **report or the formation of my opinions, which have not changed since my report was**
10 **delivered to BCBSMT on 11/12/2012. As I previously stated, BCBSMT management**
11 **provided me with historical information and discussed critical assumptions. BCBSMT**
12 **did not attempt to and did not influence my opinions.**

13 **Q: HOW WERE YOU COMPENSATED FOR YOUR REPORT?**

14 **A. I was compensated at my hourly rates for professional services provided. My**
15 **compensation was not contingent upon any of my findings or opinions.**


16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

17 **A. Yes.**

VERIFICATION

STATE OF Oregon)
) ss.
COUNTY OF Multnomah)

I, Calvin E. Swartley, being first duly sworn, upon my oath, state that I have read, know and understand the contents of the foregoing testimony and that the statements contained therein are true and correct to the best of my knowledge, information and belief.



CALVIN E. SWARTLEY

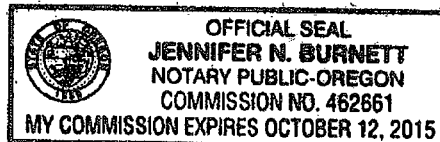
SUBSCRIBED, SWORN TO AND ACKNOWLEDGED before me this 6th day of February, 2013, by Calvin E. Swartley.



NOTARY PUBLIC

My Commission Expires:

10-12-2015



Respectfully submitted this 8 day of February, 2013.

KELLER, REYNOLDS, DRAKE,
JOHNSON & GILLESPIE, P.C.

BY: Jacqueline T. Lenmark
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CERTIFICATE OF SERVICE

I, Jacqueline T. Lenmark, KELLER, REYNOLDS, DRAKE, JOHNSON & GILLESPIE, P.C., certify that on February 8, 2013, I served a true and correct copy of the foregoing Direct Testimony of Calvin E. Swartley, CFA, ASA, by mailing it first class postage prepaid to:

Ms. Sybil Shults
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Securities & Insurance
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DATED this 8 day of February, 2013.

Jacqueline T. Lenmark
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